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28 MAY 2025

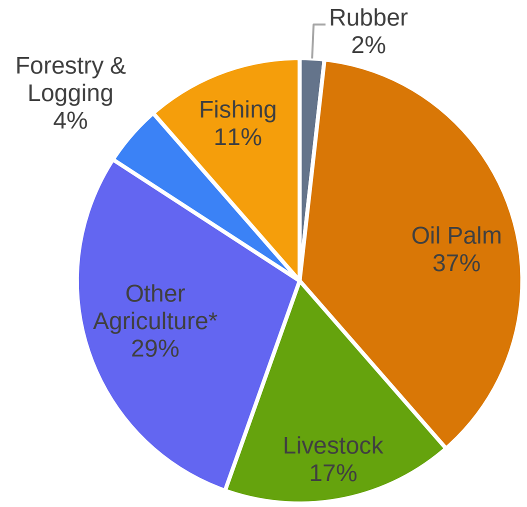
Malaysia's Plantation Sector: Economic Backbone and Land Use Dynamics

Malaysia's plantation sector plays a vital role in the national economy, forming a key component of the broader agriculture sector, which contributed approximately **6.6% to GDP** in recent years. Within this, **oil palm is the dominant crop**, generating billions in export earnings and supporting the livelihoods of over 500,000 smallholders, particularly in Sabah, Sarawak, and Johor. Malaysia is the **world's second-largest exporter of palm oil**, with exports exceeding RM114 billion[1] in 2024. Other key plantation commodities include rubber, timber, cocoa, and pepper, each contributing strategically to Malaysia's agro-based value chains.

In terms of land use, **forests cover about 57.9%[2]** of Malaysia's total land area, reflecting the government's long-standing commitment to maintain at least 50% forest cover. **Agricultural land accounts for roughly 26.1%[3] of the country's land area**, with plantations forming the bulk of this. Of these, oil palm plantations span approximately **5.6 million hectares**, while other crops like cocoa and pepper occupy much smaller areas, and livestock farming accounts for a minor share of land use, focusing mainly on poultry and swine.

To balance economic growth with environmental stewardship, Malaysia has **implemented several sustainability-oriented policies**. The Malaysian Sustainable Palm Oil (MSPO) certification is now mandatory and helps enforce good agricultural practices and traceability. Initiatives like the Central Forest Spine (CFS) aim to preserve ecological corridors between major forest complexes, while Malaysia's participation in the Heart of Borneo (HoB) project underscores its commitment to transboundary conservation. Together, **these efforts reflect a proactive and evolving approach to managing land use sustainably** in one of Southeast Asia's most plantation-intensive economies.

Contribution of Agriculture, Forestry & Fishing to Malaysia's GDP (By Subsector, % Share)



**Note: Other agriculture includes paddy, fruits, vegetables and other food crops*
Source: CEIC, DOSM

[1] Figures include crude and processed palm oil
[2,3] Figures as of 2022 by World Bank

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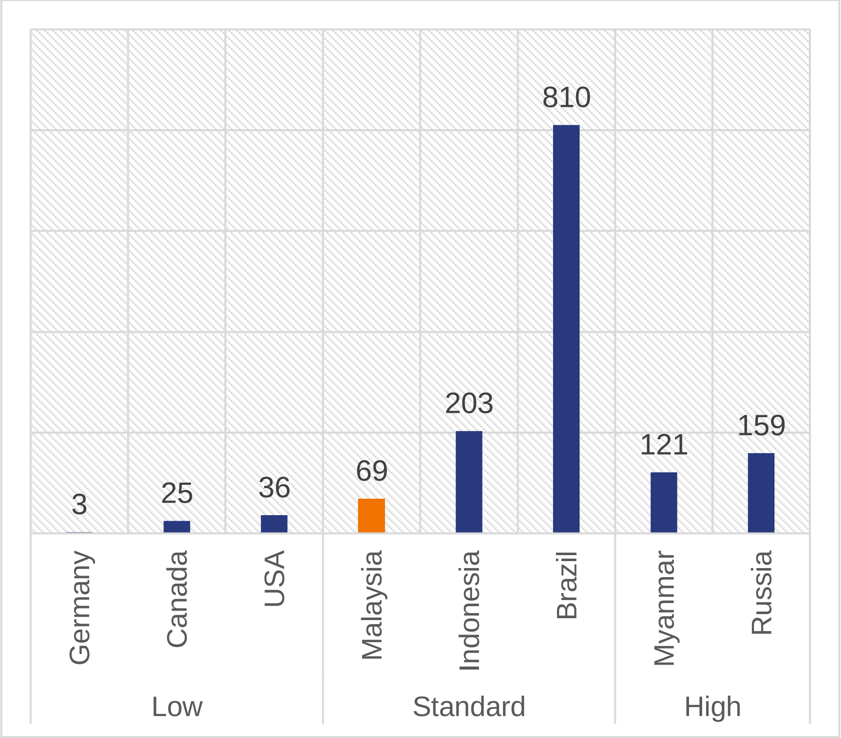
New EU Classification Sparks Trade Compliance Concerns

On 22 May 2025, the European Commission published its **first official list of country risk** classifications under the **EU Deforestation Regulation (EUDR),** categorizing nations as low, standard, or high risk based on national deforestation metrics. This marks a turning point in global trade and compliance obligations. Malaysia has been classified as a **"standard risk" country**—a designation that imposes stringent due diligence requirements on local exporters of palm oil, timber, rubber, and other commodities destined for the EU. The announcement has triggered policy debate, industry concern, and raised fresh questions on how this ruling may impact Malaysia's broader trade engagement with the EU, including ongoing FTA negotiations.

Overview of the EU Deforestation Regulation (EUDR)

The European Union's Deforestation Regulation (EUDR), effective from end-2024, is part of a broader push by the EU to decouple trade from environmental harm. It targets imports of seven key commodities—**palm oil, timber, soy, beef, coffee, cocoa, and rubber**—that are often associated with deforestation. Under this law, all companies placing these products on the EU market must **prove that their supply chains are deforestation-free**, and that goods were **produced on land not deforested** after December 31, 2020. To streamline enforcement, the EU introduced a country benchmarking system, classifying trading partners as **low, standard, or high risk** based on national deforestation rates. These risk ratings directly influence the level of due diligence required by EU importers—low-risk countries face simplified requirements, while standard and high-risk countries must meet more stringent traceability and verification rules.

Annual Forest Loss by Country (thousand hectares)



Source: Global Forest Watch

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EUDR Benchmarking: What the Numbers Miss

1 Why Was Malaysia Classified as "Standard Risk"?

The EU's benchmarking process applies two key quantitative thresholds:

1. **Absolute forest loss**: Annual forest loss must be below 70,000 hectares
2. **Relative forest loss**: Annual forest loss must be below 0.2% of total forest area

Malaysia **exceeded at least one of these thresholds** based on publicly available deforestation datasets (e.g., FAO, Global Forest Watch), hence it was assigned a "standard risk" classification. It is important to note that:

i. The assessment was nation-wide, not commodity-specific.
ii. It **did not differentiate between legal vs illegal deforestation**, nor between plantation replanting cycles vs natural forest loss.

2 Is This Classification Justifiable?

Contextually, it may be considered **overly simplistic** or even unfair for several reasons:

i. Malaysia has **mandatory national sustainability** standards (e.g., MSPO), which many "low risk" countries lack.
ii. Much of Malaysia's forest loss may be tied to **regulated land use change**, such as oil palm replanting—not indiscriminate clearing.
iii. Malaysia **has high forest cover** (~54%) and has pledged to maintain at least 50% under forest, a target it continues to meet.

So, while the numbers may meet the EU's cutoff for "standard risk," the policy effort, governance, and forest stewardship in Malaysia **arguably deserve more credit.**

3 What's Not Captured in the Benchmarking?

The current benchmarking fails to consider:

- **Policy commitments** and enforcement (e.g., Malaysia's 50% forest cover pledge, biodiversity efforts);
- **Commodity-level certification schemes** (e.g., MSPO, FSC, PEFC);
- **Context of land use** – e.g., replanting oil palm is often counted as forest loss, even though it's plantation management, not new deforestation;
- **Sub-national efforts** – States like Sabah are leaders in jurisdictional certification but get no differential treatment;

In essence, the EU methodology prioritizes satellite data over governance and sustainability frameworks.

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Reframing the EUDR Impact: Strategic Challenge, Not a Dealbreaker

It's both a short-term challenge and a long-term opportunity — but only **if Malaysia leans into it strategically**.

Why It Is a Setback in the Short Term?

Perception matters: Being classified as "standard risk" despite our sustainability efforts stings. It implies we're not on par with developed countries—even when we have national certification schemes like MSPO in place.

Trade cost impact: Exporters, especially smallholders, will face real compliance burdens—traceability, geo-location, paperwork, audits. This could erode margins or divert trade flows away from the EU.

FTA leverage lost: The EU may now expect Malaysia to "earn" better trade terms through stricter environmental concessions, tilting negotiations in their favour.

So yes, it's a real policy and reputational blow—particularly when the benchmark process itself is opaque, and developed countries conveniently classify themselves as "low risk."

But It Can Be a Long-Term Opportunity — If Malaysia Is Strategic

Elevate our global branding as a sustainable producer (especially in palm oil), breaking the stigma and improving access to ESG-sensitive markets.

Catalyze upgrades in supply chains, traceability tech, and sustainability finance—which we'll need anyway to stay globally competitive.

Strengthen our hand in future FTAs, especially if we show proactive alignment with EU standards rather than appearing resistant.

Unlock support mechanisms—the EU has pledged to work with "standard risk" countries on implementation. Malaysia can push for technical assistance and financing, particularly to support smallholders.

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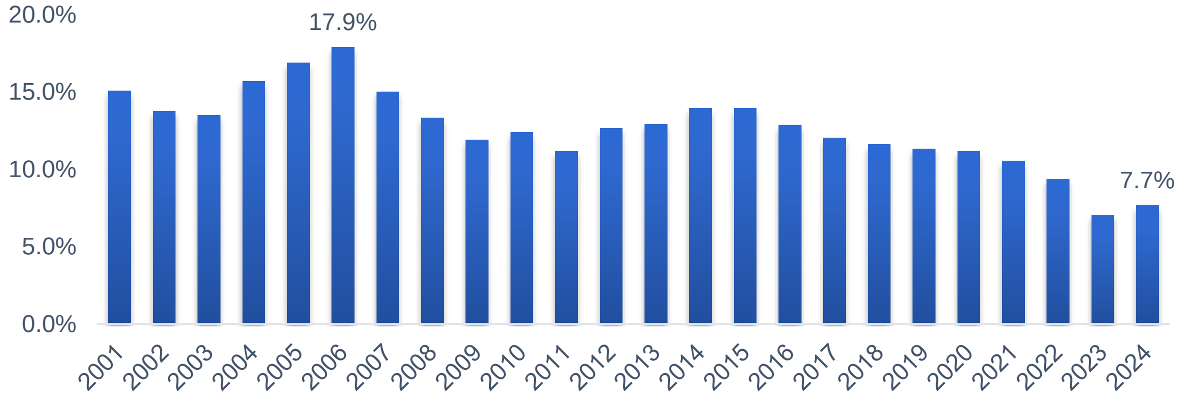
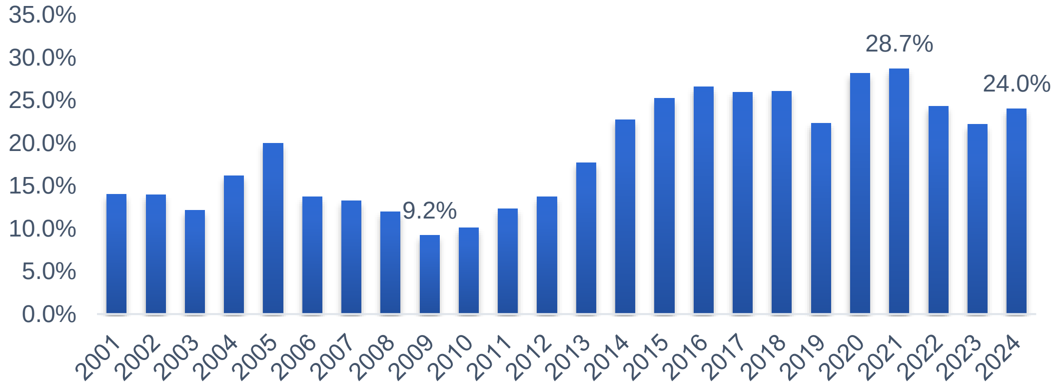
Is not all gloom and doom – Palm Kernel Oil (PKO) to the rescue

The EU is undoubtedly one of Malaysia's main client for the plantation sector specifically palm oil industries.





Sources: MPOB & CEIC

Palm oil exports to the EU accounted for 7.7% of total or 1.3 million metric ton (MT) in 2024 and the continent is deemed the third largest exports market after India (17.9%: 3.03 million MT) and China (8.2%: 1.4 million MT) of Malaysia's palm oil products. Nonetheless, other derivatives from the Fresh Fruit Bunches (FFB) which is the Palm Kernel Oil (PKO) shows a stark different scenario. Share of PKO exports to the EU constituted 24.0% of total exports or 276.3 thousand MT in 2024 and it is the largest market for Malaysia. The historical trend also suggest that exports of PKO to the EU has been on the upward trajectory. The main reasons for the distinction is due to the different treatment in respect to the regulatory compliance as PKO is deemed to be less land-intensive, and volumes are lower, making traceability and certification easier for exporters to comply with. EU buyers may see it as a "lower-risk" option to avoid regulatory complications. So there is regulatory arbitrage in the case of PKO.

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Conclusion: Navigating EUDR — Risks Acknowledged, Strategy Required

Malaysia's classification under the EU Deforestation Regulation signals a pivotal moment. While the "standard risk" label introduces near-term trade and compliance challenges, it also presents an opportunity to strengthen Malaysia's sustainability credentials and trade resilience.

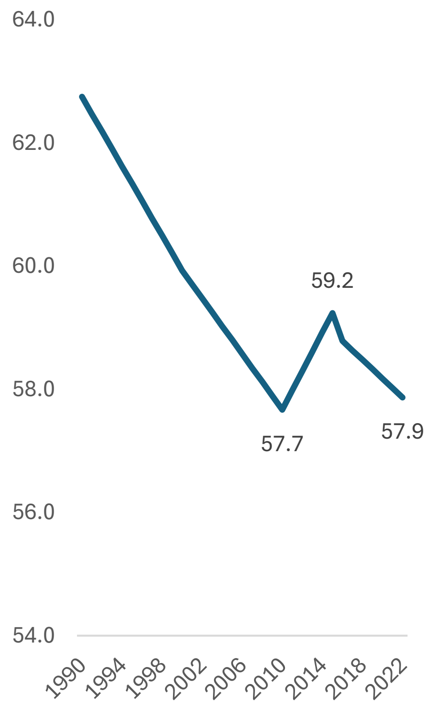
To move forward, Malaysia must:

- ✓ Enhance transparency and traceability across supply chains;
- ✓ Proactively engage with the EU to refine benchmarking frameworks;
- ✓ Push for recognition of national and subnational sustainability efforts;
- ✓ Ensure smallholders are not left behind in the compliance transition.

At the same time, diversification within the palm value chain—particularly into **Palm Kernel Oil (PKO)—offers a promising hedge**. With PKO facing fewer regulatory hurdles and enjoying rising demand in the EU, it stands as a **strategic segment** that can cushion broader compliance pressures.

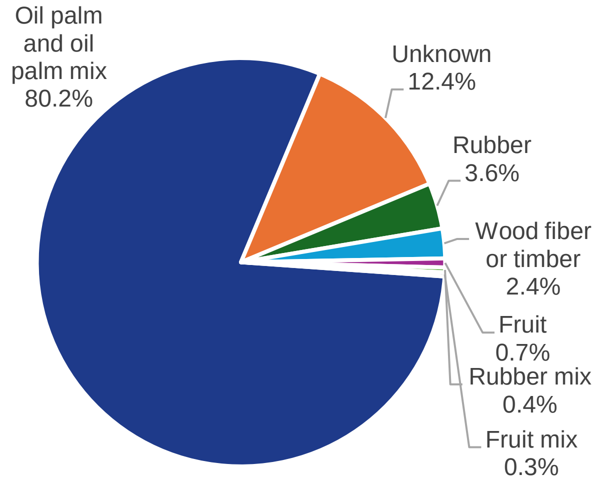
This issue **does not mark the end of the EU-Malaysia FTA path**—but rather, sets a new bar. A strategic, adaptive response could position Malaysia not only to meet the EUDR—but to lead the region in sustainable trade governance.

Malaysia's Forest Area (% of land area)



Source: World Bank

Malaysia's Plantation Area by Crop Type (%)



Source: Global Forest Watch

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Appendix: Country Classification List under the EUDR

High-Risk Countries *(subject to the most stringent compliance checks)*	**Standard-Risk Countries** *(required to conduct full due diligence for exports to the EU)*	**Low-Risk Countries** *(benefit from simplified due diligence obligations)*
• Belarus • Myanmar • North Korea • Russia	• Malaysia • Indonesia • Brazil • Paraguay • Argentina • Colombia • Democratic Republic of the Congo • Ecuador • Ethiopia • Guatemala • Honduras • Mexico • Nigeria • Peru • Tanzania • Uganda • Zambia • Zimbabwe	• United States • Canada • Australia • New Zealand • Japan • South Korea • Singapore • All 27 EU Member States

Non-exhaustive list of countries rated in EUDR

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